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SUBJECT: VENEZUELA,S PROPOSED MEGA NATURAL GAS PIPELINE FOR
SOUTH AMERICA (GASUR)

REF: CARACAS 1709

This message is sensitive but unclassified. Please treat accordingly.

1. (U) SUMMARY: Venezuela's proposed mega natural gas pipeline for South America (GASUR) -- which could span 12,000 to 15,000 kilometers and cost \$20 to \$40 billion to construct -- is Chavez's most recent and audacious effort to use the country's hydrocarbon endowment to expand his influence in the region. If realized GASUR would someday carry natural gas from fields in northeastern Venezuela to northeastern Brazil and then south through Brazil, linking up with pipelines emanating from Bolivia and extending into southern Brazil, Argentina, Paraguay, and Uruguay. Rafael Ramirez, Venezuela's Minister of Energy and Petroleum, stated in May that Petroleos de Venezuela (PDVSA) and Petrobras hope to begin project development in August 2006 with the ultimate aim of extracting gas reserves in and around the coastal Venezuelan state of Sucre. Serious questions remain, however, regarding GASUR's technical, financial, and political feasibility, particularly regarding its environmental impact, with various industry experts calling the project "pharaonic", "a dream", and "crazy". END SUMMARY.

CHAVEZ'S MOTIVE BEHIND GASUR

2. (U) Chavez has made clear that political interests are animating his push for GASUR: visiting the Vatican in May 2006, he remarked that, "if Venezuela were thinking of earning money, we would not be planning this project." Acknowledging that selling natural gas to the United States would be better for Venezuela economically, he stated "we are

certain that this project is going to be the backbone of a new model of integration in South America and, moreover, in Latin America." Chavez is thus championing GASUR as the flagship in his fleet of proposals to deepen political and economic integration among Latin American countries with Venezuela assuming a leadership role (the so called Bolivarian Alternative for the Americas, or "ALBA") (Reftel).

GASUR: A CLOSER LOOK

13. (U) Ongoing formal planning talks among the projects, primary participants -- Venezuela, Brazil and Argentina -- began in January 2006; Bolivia joined the group in May. Energy Minister Ramirez stated in May that contracts had already been signed for engineering studies regarding GASUR's construction costs and timeline, as well as its definitive route. Without explanation, however, on June 6 the energy ministers of the four currently participating countries postponed until the end of the month a meeting to evaluate construction plans previously planned for that week. The next meeting among the four heads of state is scheduled for August 2006 in Caracas, and the group has stated that project plans should be finalized by then. Minister Ramirez stated that conclusion of the planning talks in August should make possible a September meeting in Brazil among all South American countries to discuss the project's regional ramifications. Because planning talks continue, publicly available details regarding GASUR's final form are still thin.

14. (U) In its original conception, first advanced by Chavez

CARACAS 00001791 002 OF 005

in January 2006, GASUR was to be an approximately 8,000 kilometer pipeline from gas fields in eastern Venezuela southward to Brazil and Argentina. Early talks among the original three participants made clear, however, that Venezuela's gas fields would not in the near term be sufficiently developed, and Bolivia's participation was deemed necessary to feed GASUR's southern sections in the project's early stages.

15. (U) According to a May presentation by Jorge Luis Sanchez, President of Enagas, the Venezuelan state natural gas entity, in its current conception GASUR is projected to consist of three phases -- North, Central, and South -- whose pipelines would total roughly 12,000 kilometers of new construction. GASUR's North Phase is foreseen to supply 1,765 million cubic feet per day (MCFD) from as yet undeveloped fields in northeast Venezuela to Fortaleza, Brazil, on that country's northeast coast, via a new pipeline of 4,378 kilometers to be constructed through the northeast of the Amazon Basin. The Central Phase would consist of a new 2,642 kilometer pipeline to be constructed from Santa Cruz, Bolivia, eastward to Brasilia, Brazil, carrying 530 MCFD. The South Phase would consist of two new pipelines: one of 2,462 kilometers carrying 880 MCFD from Yocuibá, Bolivia, eastward through northern Argentina and on to Porto Alegre, Brazil, and another of 2,454 kilometers carrying 350 MCFD from Tarija, Bolivia, eastward through Paraguay to Montevideo, Uruguay. Specific plans for connecting the three phases along a north-south access through Brazil have not been made public, but doing so would create the "backbone" of continental integration promoted by Chavez and be necessary for Venezuelan gas to reach central and southern Brazil, Argentina, and Uruguay, as projected. Sanchez's presentation showed such a link-up conceptually and stated that it would raise the total length of the pipeline network to just over 15,000 kilometers. Venezuela plans ultimately to supply 5.3 billion cubic feet per day (BCFD) to the Southern Cone.

16. (U) Venezuelan authorities state that GASUR will cost \$20 billion to construct, but Petrobras has estimated that construction will cost "much more" than \$25 billion, while other Brazilian gas experts have said that the figure could

reach \$40 billion. The ultimate sources of GASUR,s construction financing remain unknown, though Chavez has said that Venezuela will contribute "several billion" dollars to the project, and the Inter-American Development Bank has expressed interest in taking part, should studies indicate that the project is feasible. Serious questions remain, however, regarding GASUR,s technical, financial, and political feasibility.

QUESTIONS SURROUNDING GASUR'S TECHNICAL FEASIBILITY

¶7. (U) Foremost among the challenges facing GASUR,s construction is its sheer magnitude. At roughly 12,000 kilometers for the three phases, and 15,000 if they were linked, GASUR would be more than three times the length of the longest extant pipeline, the Yamal, which runs from Russia to Eastern Europe. Simply procuring sufficient materials for the project would be difficult. A Venezuelan steel industry expert stated at recent natural gas seminar in Venezuela that 8,000 kilometers of tubing would swallow Venezuela's entire domestic steel production for a year and a half and cost \$6 billion alone. In addition, Venezuela would need to import various tubing accessories from the United

CARACAS 00001791 003 OF 005

States or Europe, as no Latin American companies produce them. The steel expert said that the total cost for the tubes and accessories for an 8,000 kilometer project would be \$12 billion. Further, components of the pipeline's attendant infrastructure -- including an estimated 40 compression stations and 160 valve stations for an 8,000 kilometer pipeline -- would need to be ordered two and half years in advance.

¶8. (U) The terrain through which the North Phase, and any eventual connection of it with the Central Phase, would have to pass is Brazil's unforgiving Amazon River Basin. The river complex is comprised of some 1,000 tributaries, which snake through the region's rainforest, legendary for its density and viewed as critical to the global environment for its carbon-dioxide processing capacity and its biodiversity. From dry to rainy season, the Amazon river's width grows from 10 to 50 kilometers and its depth increases by 7 meters. Moreover, its estuary generally measures some 240 kilometers across. Setting environmentalists, objections aside, industry experts warn that constructing the pipeline through such forbidding terrain would be daunting, making liquefied natural gas (LNG) transported by tanker a more attractive option for delivering Venezuelan gas to the Southern Cone.

¶9. (U) Questions also remain regarding the extent of Venezuela's available natural gas reserves, which it claims to be 151 trillion cubic feet (TCF). Of these, PDVSA estimated in 2003 that only 13 TCF are "free gas", i.e., not associated with petroleum deposits, and therefore available without restriction for GASUR if successfully extracted. Nelson Hernandez, an independent Venezuelan petroleum and water engineer, estimates that GASUR would require 38.7 TCF to be economically viable. What portion of Venezuela's 137 TCF of associated gas reserves would be needed for reinjection to support petroleum production remains a matter under discussion between Venezuela and Brazil. Brazilian authorities have called Venezuela's figures into question and demanded that an international body certify them and provide such an analysis directly to Petrobras.

¶10. (U) Should such reserves be confirmed to Brazil,s satisfaction, the parties to GASUR recognize that several years of investment in Venezuela's fields would be required before the gas could feed the pipeline to supply its southern consumers. In addition, Venezuela has stated repeatedly that it would not export natural gas until it satisfied its own domestic gas deficit, which currently stands at over 1.5 BCFD; Enagas projects it will not satisfy Venezuela's

domestic gas deficit until 2008. The participation of Bolivia, whose fields are geographically closer to GASUR's consumers and substantially more developed than Venezuela's, would therefore be necessary to feed the pipeline in the near-term.

QUESTIONS SURROUNDING GASUR's FINANCIAL FEASIBILITY

¶11. (U) If constructing and feeding GASUR were determined to be technically feasible, the next question would be whether the project were financially feasible. Chavez's willingness to compromise Venezuela's economic interests for the sake of his political aggrandizement is one matter, but convincing potential project financiers to do the same is another. For many analysts, Venezuela's numbers do not add up, and if they do, they do not compare favorably with shipping LNG in

CARACAS 00001791 004 OF 005

tankers to the Southern Cone.

¶12. (U) Enagas has presented figures directly comparing pipeline and LNG transport to Fortaleza, showing pipeline transport at \$1.28 per million British Thermal Units (MBTU), and LNG delivery at \$2.01/MBTU. Industry analysts accept this Enagas analysis as reasonable, but note that GASUR anticipates transporting Venezuelan gas to far more distant markets, where cost discrepancies between pipelines and LNG begin to reveal themselves. Hernandez, the independent Venezuelan engineer, has estimated that the cost to deliver Venezuelan gas via pipeline to markets in southern Brazil and Argentina could be as little as \$1.70/MBTU, but as much as \$5.00/MBTU, making LNG delivery by tanker likely to be far more economical.

¶13. (U) Further, considering not only transport, but production and distribution costs as well, Hernandez estimated that the average cost to consumers in such markets further south would be \$12.55/MBTU. In contrast, Venezuelan Energy Minister Ramirez claimed in February that, while Venezuela had yet to perform studies to determine the final price to GASUR consumers, it would ultimately be more than \$5.00/MBTU. Other industry experts estimate that only a price above \$8.00/MBTU would permit recuperation of GASUR's initial investment. By comparison, under the contracts in place before Bolivia nationalized its gas sector, Brazil and Argentina paid \$3.23/MBTU and \$3.18/MBTU, respectively. On February 21, prior to having signed on to the project, Bolivian President Evo Morales characterized as "absurd" the notion that Venezuela could ever sell its gas to Brazil or Argentina at prices competitive with Bolivia's.

¶14. (U) Venezuela's data also appear to overestimate the potential market for its natural gas in the Southern Cone. Independent analysts in Brazil forecast a domestic deficit of approximately 2.5 BCFD by 2020; Venezuela's Ministry of Energy and Petroleum (MEP), however, has claimed that GASUR would deliver as much as 4 BCFD to Brazil. Until the project's proponents are able to reconcile these supply, demand, cost and price figures, it will be difficult to convince potential investors of GASUR's financial feasibility.

QUESTIONS SURROUNDING GASUR's POLITICAL FEASIBILITY

¶15. (U) Even if studies did show the project to be technically and financially feasible, serious questions would remain regarding the political will of the GASUR coalition. Rifts between the parties have surfaced. Bolivia has argued that the project should be undertaken only by state-owned companies and has balked at partially private-sector-owned Petrobras's participation. In response, Brazilian Foreign Minister Celso Amorim declared that if Petrobras does not

participate in GASUR, there will be no GASUR, very simple.⁸
The parties have yet publicly to reconcile these matters.

¶16. (U) The issue has in fact assumed greater salience in the wake of Bolivia's nationalization of its gas sector * including Petrobras assets * and Bolivian accusations of Petrobras malfeasance in Bolivia's gas market. In addition, a Bolivian professional association of hydrocarbons industry participants has complained that GASUR runs against Bolivia's interests as it will displace Bolivia as the leader in the Southern Cone's natural gas market.

CARACAS 00001791 005 OF 005

¶17. (U) For its part Brazil has expressed concerns regarding who would construct, regulate, and control GASUR,s infrastructure, much of which will lie within Brazil's territory. El Universal, the leading Venezuelan daily for coverage of the hydrocarbons sector, reported on May 10 that Foreign Minister Amorim stated before the Brazilian Senate that Venezuela would only transport gas to the Amazonian city of Manaus: from there the system of pipelines comprising GASUR in Brazil would be "entirely national", so as to reduce Brazil,s dependence on foreign gas. According to the same piece, Mauricio Tolmaskim of Brazil,s Ministry of Energy and Mines elaborated that under GASUR "each country would be responsible for the pipeline in each part of its territory, and the project would be an amalgamation of efforts." Furthermore, Brazil,s Vice-Minister of Energy and Mines, Nelson Hubner Moreira, drew attention to the risk of wedding the country to Venezuelan and Bolivian state gas entities, stating that "there would have to be guaranteed long-term supply contracts and they would have to be fulfilled by private companies or by Petrobras."

¶18. (U) Political pressures have likewise emanated from sources beyond the parties themselves: environmental groups have raised alarms about the project's potential impact. Nelson Hernandez, the Venezuelan engineer, noted that constructing GASUR would entail cutting a 25-meter-wide swathe through the Amazon jungle along the pipeline's route, and more deforestation would be required for access roads and pressure and valve stations. Work on GASUR could also disrupt various indigenous communities along its proposed route in both Venezuela and Brazil. Addressing such issues in Brazil implies real time and costs: recently, inaugurating the commencement of work on a much smaller, 670 kilometer pipeline in the Amazon region, Brazilian President Lula da Silva remarked that two years of courtroom battles with environmental prosecutors had passed since the decision had been taken to construct that project. Roberto Smeraldi, director of Friends of the Earth/Brazilian Amazon, has estimated that securing the necessary Brazilian environmental permits to cross the Amazon would take at least five or six years. A Venezuelan environmental group, Friends of the Great Savannah, has stated that the project would be "the definitive step for the destruction of the Amazon, the Venezuela Guayana and diverse ecosystems of the Caribbean and Atlantic Coastline."

¶19. (SBU) COMMENT: Many obstacles lie in GASUR's path -- technical, financial, and political -- but Chavez has clearly made the project a priority and is expending substantial political capital in the region to promote it. As the project moves forward, the challenges of finding financing, resolving disputes among the participants -- particularly between Brazil and Bolivia -- and addressing environmentalists' concerns will become more acute. The parties may reach a working agreement by August and preliminary labor on certifying Venezuelan gas reserves for extraction may begin before the end of the year. But it is highly unlikely that, seven years from now, anything like the GASUR project foreseen by Chavez will exist. END COMMENT
WHITAKER